(32)

No. 91-615

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

ALLIED SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation,
Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of New Jersey

BRIEF OF TAX EXECUTIVES INSTITUTE, INC. AS AMICUS CURIAE SUPPORTING REVERSAL

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INTEREST OF AMICUS CURIAE

Pursuant to Rule 37 of the Rules of this Court, Tax Executives Institute, Inc. respectfully submits this brief as *amicus curiae*.[1] Tax Executives Institute (hereinafter "TEI" or "the Institute") is a voluntary, non-profit association of corporate and other business executives, managers, and administrators who are responsible for the tax affairs of their employers. The Institute was organized in 1944 and currently has approximately 4,800 members who represent more than 2,000 of the leading corporations in the United States and Canada. TEI is dedicated

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[1] Tax Executives Institute has received the written consents of the Petitioner and Respondent to the filing of this brief; those consents have been filed with the Clerk of the Court.

to promoting the uniform and equitable enforcement of the tax laws throughout the Nation and to reducing the costs and burdens of administration and compliance to the benefit of both the government and taxpayers.

The members of the Institute represent a cross-section of the business community in North America, and the multijurisdictional companies represented by the Institute's membership are significantly affected by the rules governing the allocation and apportionment of income among the various States. As a result, nearly all the Institute's members will be directly affected by the resolution of this case. If the New Jersey Supreme Court's decision stands, taxpayers throughout the Nation will suffer from the resulting uncertainty, the increase in the cost and burden of compliance, and the enhanced potential for duplicative taxation. As the individuals who must contend daily with the interpretation and administration of the Nation's tax laws, the Institute's members have a vital interest in the proper disposition of this case.

SUMMARY OF ARGUMENT

Under the Commerce and Due Process Clauses of the Constitution,[2] a State may not tax value outside its borders. Such taxation is proscribed because the "fundamental purpose of the [Commerce] Clause is to assure that there be free trade among the several States," *Boston Stock Exch. v. State Tax Comm'n,* 429 U.S. 318, 335 (1977), and because extraterritorial taxation offends fundamental notions of due process and constitutes an "unreasonable clog upon the mobility of commerce." *Baldwin v. G.A.F. Seelig, Inc.,* 294 U.S. 511, 527 (1935).

This case involves the limitations on the States' power to apportion income of a nondomiciliary taxpayer where that income bears no, or only a marginal, connection with

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[2] U.S. Const. art. I, § 8, cl. 3 (Commerce Clause); U.S. Const. amend. XIV, § 1 (Due Process Clause).

the taxpayer's activities in the State. Due process requires some definite link—or nexus—between the State and the person to be taxed. Without such a connection, the taxing scheme will be struck down as violating both the Due Process and Commerce Clauses.

Apportionment formulae are generally used to determine what part of a taxpayer's income may be properly taxed by the respective States. More than a century ago, this Court held that the taxability of a nondomiciliary taxpayer's out-of-state income turned on the application of the "unit rule" or the unitary business principle—on whether the out-of-state item sought to be taxed was "unitary" with, or functionally related to, the taxpayer's in-state activities. *State R.R. Tax Cases*, 92 U.S. 575, 608 (1875). Twelve years ago, in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 439 (1980), the Court encapsulized its prior holdings by declaring the unitary business principle to be the "linchpin of apportionability in the field of state income taxation." Subsequently, this Court decided *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982); *F.W. Woolworth Co. v. Taxation & Revenue Dep't*, 458 U.S. 354 (1982); and *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983), which reaffirmed the bedrock unitary business principle and established standards for determining whether the requisite link exists between a nondomiciliary taxpayer's business activities within the State and its investments in or income from other nondomiciliary corporations.

The issue here is not simply whether *ASARCO* and *Woolworth* should be overruled, but whether the States are free to apportion all the income of nondomiciliary taxpayers, without regard to whether any connection exists between the State, the income, and the taxpayer's in-state activities. *Amicus* TEI fears that the evisceration of the unitary business principle would convert the current high potential for duplicative taxation into reality.

If these cases were overruled, the same income could well be subject to multiple taxation by various States.

This Court should be loath to overturn the unitary business principle. As it observed last term, "[*s*]*tare decisis* is the preferred course because it promotes the evenhanded, predictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process." *Payne v. Tennessee*, 111 S. Ct. 2597, 2609 (1991).

Because the repudiation of *ASARCO* and *Woolworth* would constitute a major departure from longstanding principles of Due Process and Commerce Clause jurisprudence, any decision overturning those cases should apply on a prospective-only basis. Such a decision would meet the test for non-retroactive application enunciated in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971); (i) the decision would establish a "new principle of law" that could not have been foreseen by taxpayers; (ii) retroactivity would not vindicate the Due Process or Commerce Clause rights of any of the parties; and (iii) prospectivity would be absolutely necessary to avoid injustice and hardship to the multijurisdictional taxpayers that relied on those cases in good faith.

If *ASARCO* and *Woolworth* were overturned, a balance should be struck between the States' legitimate need for revenues from activities to which the States accord some benefit and taxpayers' legitimate need for, and constitutional right to, protection from taxing authorities that seek to throw a net over income with which the States have no substantial connection. Uniform definitions and apportionment rules would be critical. In the absence of the unitary business principle, judicially prescribed uniformity would be essential to safeguarding the Due Process and Commerce Clause rights of multijurisdictional businesses. In other words, the Court's well-founded reluctance to assume this duty should lead it not to sanc-

tion an "anything goes" approach by the States, but rather to reaffirm the vitality of *ASARCO* and *Woolworth* while inviting Congress to address the matter legislatively.

The decision of the Supreme Court of New Jersey should be reversed.

ARGUMENT

In restoring this case to the calendar for reargument, the Court requested the parties and *amici* to address the following three questions:

- Should the Court overrule *ASARCO [Inc.] v. Idaho State Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Department*, 458 U.S. 354 (1982)?
- If *ASARCO* and *Woolworth* were overruled, should the decision apply retroactively?
- If *ASARCO* and *Woolworth* were overruled, what constitutional principles should govern state taxation of corporations doing business in several States?

These three questions are addressed seriatim.

I. *ASARCO* AND *WOOLWORTH* SHOULD NOT BE OVERRULED

A. Constitutional Limitations on State Taxation of Multijurisdictional Businesses: Has the State "Given Anything for Which It Can Ask Return"?

Under the Commerce Clause and Due Process Clause of the Constitution, a State may not tax value earned outside its borders. *E.g.*, *Connecticut General Life Ins. Co. v. Johnson*, 303 U.S. 77, 80-81 (1938); *see* U.S. Const. art. I, § 8, cl. 3; U.S. Const. amend. XIV, § 1. Such taxation is proscribed because the "fundamental purpose of the [Commerce] Clause is to assure that there be free trade among the several States," *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 335 (1977),

and because extraterritorial taxation offends fundamental notions of due process and constitutes an "unreasonable clog upon the mobility of commerce." *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935); *see* Paul J. Hartman, *Federal Limitations on State and Local Taxation* §§ 2.2, 2.3 (1981). "State taxation falling on interstate commerce . . . can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys." *Freeman v. Hewit*, 329 U.S. 249, 253 (1946).

This case involves the limitations on the States' power to apportion income of a nondomiciliary taxpayer where that income bears no, or only a marginal, connection with the taxpayer's activities in the State. In determining whether a particular state taxing scheme is constitutionally valid, this Court has held that "due process requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Bros. v. Maryland*, 347 U.S. 340, 344-45 (1954).[3] Absent a sufficient connection or "nexus" between the State and the person, property, or transaction to be taxed, the "fairness" of the particular levy—whether it is properly apportioned or whether it is reasonably related to the services provided by the State—is irrelevant: it will be struck down as violating both the Due Process

[3] The threshold importance of this "direct link" or "nexus" requirement was reaffirmed by this Court's seminal Commerce Clause decision in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). That case sets forth a decisional framework for Commerce Clause inquiries that incorporates the Due Process Clause's nexus test as a threshold requirement and then requires a balancing of the competing interests in determining whether the tax infringes on interstate commerce. *Id.* at 279 (the test under the Commerce Clause is whether the tax "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State"). *See, e.g., Trinova Corp. v. Michigan Dep't of Treasury*, 111 S. Ct. 818, 828-29 (1991); *Exxon Corp. v. Department of Revenue*, 447 U.S. 207, 227-28 (1980).

Clause and the Commerce Clause. *See Trinova Corp. v. Michigan Dep't of Treasury,* 111 S. Ct. 818, 828-29 (1991); *Mobil Oil Corp. v. Commissioner of Taxes,* 445 U.S. 425, 436-37 (1980). In other words, if the connection is insubstantial or remote, the State has not "given anything for which it can ask return." *Wisconsin v. J.C. Penney Co.,* 311 U.S. 435, 444 (1940).[4]

B. Apportionment Methods and the Overarching Importance of the Unitary Business Principle in Preventing Extraterritorial Taxation

In *Northwestern States Portland Cement Co. v. Minnesota,* 358 U.S. 450 (1959), the Court confirmed that "the entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs." *Id.* at 460. Hence, apportionment formulae are used to determine what part of a taxpayer's income may be properly taxed by the respective States. For example, under the Uniform Division of Income for Tax Purposes Act (UDITPA), the apportionment formula compares (i) the taxpayer's property, payroll, and sales (receipts) within the taxing State to (ii) the taxpayer's total property, payroll, and sales. UDITPA §§ 9-17. The purpose of the apportionment formula is to assign to the taxing State the amount of the taxpayer's total income that is earned in, and therefore is reasonably attributable to, the State.

The general permissibility of formulary apportionment, however, should not obscure the Constitution's limitation on the States' ability to tax out-of-state income. As the

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[4] In *J.C. Penney Co.,* the Court framed the inquiry, as follows: "[W]hether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return." 311 U.S. at 444.

Court held in *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983), "[u]nder both the Due Process and Commerce Clauses of the U.S. Constitution, a State may not, when imposing an income-based tax, 'tax value earned outside its borders.'" *Id.* at 164, *quoting ASARCO*, 458 U.S. at 315. Consequently, formulary apportionment is permissible only to the extent that the result is a "'rough approximation' of the corporate income that is 'reasonably related to the activities conducted within the taxing state.'" *Exxon Corp. v. Department of Revenue*, 447 U.S. 207, 223 (1980), *quoting Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273-74 (1978). *See Wallace v. Hines*, 253 U.S. 66, 69 (1920) (Holmes, J.) (the purpose of formulae based on values both within and without a State is not "to open to taxation what is not within the State," but only to estimate the true values of the things within it).

What connection, or nexus, must exist between a State and a nondomiciliary taxpayer's income from out-of-state sources or activities before that income can be apportioned to the State? More than a century ago, this Court held that this question turned on the application of what has become known as the unitary business principle—on whether the out-of-state item that the State was seeking to tax was "unitary" with, or functionally related to, the taxpayer's in-state activities. In *State R.R. Tax Cases*, 92 U.S. 575, 608 (1875), the Court adopted a "unit rule" under which railroads could be taxed on the apportioned value of their unitary nationwide property. The Court's theory was that the taxpayer's unitary property in each State contributed to and enhanced the value of the property of the whole enterprise. As the Court explained in *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194, 222 (1897), "while the unity which exists may not be a physical unity, it is something more than a mere unity of ownership. It is a unity of use, not simply for the convenience or pecuniary profit of the owner, but exist-

ing in the very necessities of the case—resulting from the very nature of the business."[5]

Eighty-three years later, in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), the Court encapsulized its prior holdings by declaring that "the linchpin of apportionability in the field of state income taxation is the unitary-business principle," *id.* at 439, describing a unitary business as one marked by "functional integration, centralization of management, and economies of scale." *Id.* at 438. The essence of the Court's factual finding in *Mobil* was that the taxpayer had failed to prove that dividend income from foreign subsidiaries (among other sources) was "earned in the course of activities *unrelated to*" its business activities. *Id.* at 439 (emphasis added). The Court explained, however:

> Where the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State, due process considerations might well preclude apportionability, because there would be no underlying unitary business.

Id. at 441-42. *Accord Exxon Corp.*, 447 U.S. at 223, *quoting Mobil*, 445 U.S. at 439.

Subsequently, this Court decided *ASARCO*, *Woolworth*, and *Container*. In the first two cases, the Court concluded that no unitary relationship existed between the States of Idaho and New Mexico, respectively, and the intangible income derived from investments in subsidiaries that those States sought to apportion. The Court found that the subsidiaries were, as a factual matter, " 'discrete business enterprise[s]' that—'in any business or economic sense'—have 'nothing to do with the activities' " of the tax-

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[5] *See Hans Rees' Sons, Inc. v. North Carolina* ex rel. *Maxwell*, 283 U.S. 123, 133 (1931) (unitary business principle gives effect to the Due Process and Commerce Clause requirement that the State's taxing scheme reach "only the profits earned within the state"), *quoting Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920).

payer in the State. *ASARCO*, 458 U.S. at 328, *quoting Mobil*, 445 U.S. at 439-42. *Accord Woolworth*, 458 U.S. at 372 (each foreign subsidiary operated as a " 'discrete business enterprise,' *Mobil*, *supra* at 439, with a notable absence of any 'umbrella of centralized management and controlled interaction.' *Exxon*, 447 U.S. at 224."). Consequently, the intangible income derived from those subsidaries could not constitutionally be included in the apportionable tax base.

In *Container*, this Court applied the same, self-described "well established" unitary standard to reach the opposite factual conclusion. 463 U.S. at 176-77. The Court held the taxpayer—a paperboard manufacturer—and its foreign subsidiaries were engaged in a unitary business because there was a substantial "flow of value" between the taxpayer and the subsidiaries. The Court explained:

> The functional meaning of this [unitary business] requirement is that there be some sharing or exchange of value not capable of precise identification or measurement—beyond the mere flow of funds arising out of a passive investment or a distinct business operation—which renders formula apportionment a reasonable method of taxation.

Id. at 166.

Thus, *ASARCO*, *Woolworth*, and *Container*—and *Mobil* and *Exxon*, as well—reaffirmed the vitality of the bedrock unitary business principle and established standards for determining whether the requisite unitary link exists between a nondomiciliary taxpayer's business activities within the State and its extraterritorial investments in or income from other nondomiciliary corporations. The unitary business principle assures that the use of formulary apportionment will be limited to situations where necessary to measure the income attributable to activities in the taxing State. Where a corporation conducts two wholly separate or discrete businesses in different States, formulary apportionment is not necessary—and should

not be permitted—because separate accounting succeeds in measuring the income attributable to the discrete business activities conducted in the taxing States. As this Court said just last year in *Trinova Corp.*, "to allow apportionment where there is no practical or theoretical justification could provide the opportunity for a state to export tax burdens and import tax revenues." 111 S. Ct. at 829.

C. A Decision to Overrule *ASARCO* and *Woolworth* Would Be A Decision to Repudiate the Unitary Business Principle

The foregoing summary of this Court's decisions confirms the broad scope of the first question posed by the Court in setting this case for reargument. The issue is not simply whether *ASARCO* and *Woolworth* should be overruled, for those cases involved simply the application of an established constitutional principle to specific sets of facts.[6] Rather, the Court's question goes to the continued vitality of the unitary business principle itself: Whether the States are free to apportion any and all income of nondomiciliary taxpayers, without regard to whether any, or only an insubstantial, connection exists between the State, the income, and the taxpayer's in-state activities or business.

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[6] In *ASARCO*, the Court observed that the unitary business principle had been a "familiar concept in our tax cases for more than 60 years," 458 U.S. at 320 n.14—back at least to Justice Holmes's 1920 opinion in *Wallace v. Hines* (and, some would argue, back to the 1875 decision in *State R.R. Tax Cases*). Indeed, the Court in *ASARCO* stated that a review of its pre-*Mobil* decisions (including the 1897 decision in *Adams Express*) unmistakably demonstrates that "[f]ormulary apportionment, which takes into account the entire business of a multistate business in determining the income taxable by a particular state, is constitutionally permissible only in the case of a unitary business." *Id., quoting* E. George Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups*, 25 Tax L. Rev. 171, 183-84 (1970).

To overrule *ASARCO* and *Woolworth*, the Court would essentially have to conclude that corporate purpose alone should define unitary business. Just as the State argued in *ASARCO*, the Court would have to rule that "intangible income should be considered a part of a unitary business if the intangible property (the shares of stock) is 'acquired, managed or disposed of for purposes relating or contributing to the taxpayer's business.'" *ASARCO*, 458 U.S. at 326 (quoting the State of Idaho's brief). Such an open-ended definition of unitary business, however, would emasculate the concept. As Justice Powell reasoned in *ASARCO*, "[w]hen pressed to its logical limit, this conception of the 'unitary business' limitation becomes no limitation at all"—it "would destroy the concept." *Id.*

The "everything is unitary" analysis propounded by the State of New Jersey should be seen for what it is: an effort to "subvert[] the unitary-business limitation." *Woolworth*, 458 U.S. at 364 n.11. Under its so-called standard, "[*a*]*ll* dividend income—irrespective of whether it is generated by a 'discrete business enterprise,' *Mobil*, 445 U.S. at 439—would become part of a unitary business if the test were whether the corporation commingled dividends from other corporations, whether subsidiaries or not." *Woolworth*, 458 U.S. at 364 n.11 (emphasis in original).

D. Overruling *ASARCO* and *Woolworth* Would Exacerbate the Potential for Duplicative Taxation

The fundamental purpose of the unitary business principle is to ensure the Due Process Clause rights of multijurisdictional businesses by preventing extraterritorial taxation by the States and placing limits on the potential for duplicative taxation. *Amicus* TEI fears that—absent the imposition of other, arguably more administratively burdensome and intrusive limitations—the evisceration of the unitary business principle would convert the potential for duplicative taxation into reality. And given the

Court's historical reluctance to dictate the specific components of a given State's allocation and apportionment scheme, *Moorman Mfg. Co.*, 437 U.S. at 278-80, the development and imposition of such limitations are not guaranteed.[7]

The unitary business principle operates to limit a State's power to tax the intangible income of nondomiciliary multijurisdictional corporations. Consequently, a decision overruling *ASARCO* and *Woolworth* (and, hence, destroying the unitary business principle) would unleash the States to impose tax on intangible income, without regard to the connection between the income and the taxpayer's activities in the State. Absent clear direction from this Court, such a decision would not *require* all the States to apportion such income, only *free* them to do so, unfettered by the limitations inherent in the unitary business principle. At the same time, the State of commercial domicile would presumably retain the right to allocate the same income.[8]

Clearly, allocation and apportionment of the same income should not occur. "Taxation by apportionment and taxation by allocation to a single situs are theoretically incommensurate, and if the latter method is constitutionally preferred, a tax based on the former cannot be sustained." *Mobil*, 445 U.S. at 444-45, *citing Standard Oil Co. v. Peck*, 342 U.S. 382, 384 (1952). In other words, because apportionment is a surrogate for allocation, income may not be apportioned if it is fully allocable to a single State. If *ASARCO* and *Woolworth* were overruled, however, the same income could well be subject

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[7] The limitations that *amicus* TEI believes the Court should impose if *ASARCO* and *Woolworth* are overruled are discussed in Part III, *infra*.

[8] Sections 6(c) and 7 of UDITPA allocate capital gains from intangible property, interest, and dividends to the State of commercial domicile.

to both allocation and apportionment, with double taxation being the result.

For example, assume that a company that is domiciled in Pennsylvania operates two grocery stores, one in Pennsylvania (which it operates directly) and one in New Jersey (which it operates through a subsidiary). The property, payroll, and sales factors of the two companies are identical, so that 50 percent of apportionable income is taxed in each State.[9] In addition, the Pennsylvania company owns stock in an unrelated foreign company. In 1990, the Pennsylvania grocery store makes $100 and the New Jersey store also makes $100; in addition, the Pennsylvania company receives $1,000 of capital gain income from the sale of the foreign company stock. As the State of commercial domicile, Pennsylvania allocates the capital gain to itself and apportions the aggregate $200 of grocery store income in accordance with the three-factor formula; *i.e.*, the company's Pennsylvania income is computed to be $1,100. Under New Jersey's analysis, the capital gain would be apportionable, so the company's New Jersey income would be deemed to be $600 (½ [$200 unitary income + $1,000 intangible income]). Hence, although the company realized only $1,200 of total income, an aggregate of $1,700 would be subject to tax.[10]

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[9] For simplicity's sake, assume that the two States have statutory schemes that apportion all business income by way of a three-factor formula with equal weighting to each factor; differences between the apportionment formulae used by the States could exacerbate the degree of duplicative taxation.

[10] As a constitutional matter, it is immaterial whether the State of commercial domicile chooses to allocate all the income to itself. The issue is the nondomiciliary States' *power* to tax, and clearly that power (as constrained by the Due Process Clause) does not expand or contract as the State of commercial domicile exercises or disclaims the full extent of its own power to tax. As the Court observed in *Mobil*, "the constitutionality of a Vermont tax should not depend on the vagaries of New York tax policy." 445 U.S. at 444.

E. *Stare Decisis* and the Rule of Law

In disregarding or distending this Court's numerous decisions applying the unitary business principle—including *ASARCO* and *Woolworth*—the New Jersey court ignored a basic principle of constitutional adjudication: It is this Court that prescribes constitutional standards and the lower courts are obliged to adhere to those standards "no matter how misguided the judges of those courts may think [them] to be." *Hutto v. Davis*, 454 U.S. 370, 375 (1982); *accord Cooper v. Aaron*, 358 U.S. 1, 18 (1958); *The Mayor v. Cooper*, 73 U.S. (6 Wall.) 247, 253 (1867) (if the lower courts did not adhere to Supreme Court precedent, there would be "mischievous consequences").

New Jersey, moreover, is not alone in its assault on the Due Process and Commerce Clause protections afforded to multijurisdictional businesses. Taxing authorities in many States have endeavored to chip away at the unitary business principle and the constitutional limitations on state taxation as set forth in *Mobil*, *Exxon*, *ASARCO*, *Woolworth*, *Container*, and earlier cases. For the States, the coin of the realm is seemingly not principle, but revenue.

The unapologetic efforts by the States to tax a portion of intangible income received from non-unitary entities is "a mere effort to reach profits earned elsewhere under the guise of legitimate taxation." *See Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271, 283 (1924). *Amicus* TEI submits that the States' persistent defiance of precedent cannot be allowed to stand, and it certainly should not be rewarded. If these actions by the States, untethered by principle, are not beyond the pale of the Due Process Clause and the Commerce Clause, then just exactly what protection does the Constitution provide?

Amicus TEI believes the Court should be chary to overturn the unitary business principle and to roil the waters of state taxation of multijurisdictional businesses. As the

Court observed last term "[*s*]*tare decisis* is the preferred course because it promotes the evenhanded, predictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process." *Payne v. Tennessee*, 111 S. Ct. 2597, 2609 (1991).

Concededly, the doctrine of *stare decisis* does not mean that all this Court's previous decisions are sacrosanct. But the doctrine is--and should be—"of fundamental importance to the rule of law." *Welch v. Texas Dep't of Highways & Public Transp.*, 483 U.S. 468, 494 (1987).[11] As Justice O'Connor wrote in *Arizona v. Rumsey*, 467 U.S. 203 (1984):

> Although adherence to precedent is not rigidly required in constitutional cases, any departure from the doctrine of *stare decisis* demands special justification. See, *e.g.*, *Swift & Co. v. Wickham*, 382 U.S. 111, 116 (1965); *Smith v. Allright*, 321 U.S. 649, 665 (1944).

Id. at 212. This is especially true where the case pertains to property and contract rights, as well as commercial dealings, which involve reliance interests. *Payne*, 111 S. Ct. at 2610.[12]

* * * *

[11] *Accord Hilton v. South Carolina Public Rys. Comm'n*, 112 S. Ct. 560, 563 (1991) (emphasizing "the central importance of *stare decisis* in this Court's jurisprudence").

[12] In *Payne*, Chief Justice Rehnquist noted that one reason the doctrine of *stare decisis* is not as compelling in constitutional cases as elsewhere is that in such cases "correction through legislative action is practically impossible." 111 S. Ct. at 2610, *quoting Burnet v. Coronado Oil & Gas Co.*, 285 U.S. 393, 407 (1932) (Brandeis, J., dissenting). But here, as the Court has acknowledged on many occasions, Congress clearly *does* have the power under the Commerce Clause to intercede and establish firm rules. *See, e.g., Moorman Mfg. Co.*, 437 U.S. at 280 ("It is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income.").

Amicus TEI believes the question—*whether ASARCO and Woolworth should be overruled and the unitary business principle be effectively jettisoned from the matrix of constitutional adjudication*—begs its own answer: absolutely not. Indeed, the Court should affirm the vitality of the unitary business principle and hold that the Due Process Clause and Commerce Clause continue to bar efforts to levy upon income that is not properly "within the reach of [the State's] taxing power." *Connecticut General Life Ins.*, 303 U.S. at 80.

II. ANY DECISION OVERRULING *ASARCO* AND *WOOLWORTH* AND UNDERMINING THE UNITARY BUSINESS PRINCIPLE SHOULD BE WHOLLY PROSPECTIVE

For more than 100 years, multijurisdictional businesses have relied on the unitary business principle in conducting their business affairs. The repudiation of that principle and the overruling of *ASARCO* and *Woolworth* would represent a major departure from longstanding principles of Due Process and Commerce Clause jurisprudence. The retroactive application of any decision curtailing the protections afforded by the unitary business principle would work a major hardship on interstate commerce and unjustly reward the States for repudiating this Court's holdings.

The retroactive abrogation of the unitary business principle would also send an ominous signal to all taxpayers concerning their ability to rely on established rules. Not only would multijurisdictional taxpayers be exposed to unexpected and potentially enormous tax liabilities for all open tax years, but they would be deprived of the certainty necessary to conduct their business affairs in an orderly manner, undermining the very purpose of the Commerce Clause. Consequently, if the Court were to overrule *ASARCO* and *Woolworth*, that decision should be applied on a prospective-only basis.

In respect of civil cases, the factors to be analyzed in resolving the retroactivity issue were enunciated by the Court in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971). In that case, the Court held that in determining whether a decision should be applied on a prospective-only basis, three factors should be considered:

- *Reliance:* Whether the decision establishes a new principle of law or involves an issue of first impression whose resolution was not clearly foreseen.
- *Purpose:* Whether, based on the history of the rule in question, its purpose and effect, non-retroactive application will advance or retard the operation of the new rule.
- *Inequity:* Whether non-retroactive application is necessary to avoid injustice or hardship.

404 U.S. at 106-07 (paraphrased). Applying the *Chevron* test to the possible overruling of *ASARCO* and *Woolworth* —and the consequent evisceration of the unitary business principle—demonstrates that any such decision should be prospective only.

Clearly, a decision overruling *ASARCO* and *Woolworth* would establish "a new principle of law." Such a decision could not have been foreseen by taxpayers. Indeed, the unbroken chain of Supreme Court cases upholding the vitality of the unitary business principle did nothing but affirm the concept's vigor and pertinence. Thus, multi-jurisdictional taxpayers unmistakably had constitutionally sufficient cause to rely on *ASARCO*, *Woolworth*, and their predecessors. *Chevron*'s threshold test is satisfied.

Second, the non-retroactive application of a decision overruling *ASARCO* and *Woolworth* would not retard the operation of the post-*ASARCO/Woolworth* rule. After all, the effect of such a decision would not be to vindicate the Due Process and Commerce Clause rights of taxpayers —as was the case in *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 110 S. Ct. 2238, 2253-54

(1990)—but simply to permit (not require) non-domiliary States to apportion intangible income.

Third, the non-retroactive application of a decision overruling *ASARCO* and *Woolworth* is absolutely necessary to avoid injustice and hardship to the multijurisdictional businesses that relied in good faith on those cases and the unitary business principle. The abandonment of the unitary concept would constitute an abrupt break with the past. Such a move would free the States to scrutinize the tax returns of nondomiciliary taxpayers for all open tax years, thereby upsetting well-founded expectations and exposing the taxpayers not only to the danger of duplicative taxation but also to unavoidable administrative costs. *See Chevron Oil Co.*, 404 U.S. at 106-07 (*citing Cipriano v. City of Houma*, 395 U.S. 701, 706 (1969)). As Justice O'Connor explained in *American Trucking Ass'ns v. Smith*, 110 S. Ct. 2323 (1990), "[w]hen the Court concludes that a law-changing decision should not be applied retroactively, its decision is usually based on its perception that such application would have a harsh and disruptive effect on those who relied on prior law." *Id.* at 2338.[13] Such a harsh and disruptive effect would undeniably be visited upon the multijurisdictional businesses that for more than a century have relied on the unitary business principle. Moreover, the effect of a retroactive decision could be decidedly uneven among taxpayers. Some taxpayers may have only a few years still open under the applicable statute of limitations, whereas others (at least in some States) could have open years extending back to even before *ASARCO* and *Woolworth* were decided.

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[13] *See id.* at 2342 (the purpose of prospectivity is "cushioning the sometimes inequitable and disruptive effects of law-changing decisions"); *United States v. Estate of Donnelly*, 397 U.S. 286, 295 (1970) (Harlan, J., concurring) (the doctrine of *stare decisis* is intended to "avoid jolting the expectations of parties to a transaction").

Where this Court holds a particular practice or taxing scheme to be unconstitutional, the legal system's "built-in presumption of retroactivity," *Solem v. Stumes*, 465 U.S. 638, 642 (1984), should generally obtain. Thus, in *McKesson*, the Court held that the Florida statute there in issue was unconstitutional *ab initio* and that, consequently, the taxpayer was entitled to relief in respect of the discriminatory taxes paid into the State. 110 S. Ct. at 2253-54.

McKesson, however, does not dictate a retroactive decision here. Indeed, since the present case involves a dilution of taxpayers' Due Process and Commerce Clause rights (not their enhancement), there are compelling reasons to apply the decision on a prospective-only basis even if the *Chevron* standards were not clearly satisfied. Hence, the overruling of *ASARCO* and *Woolworth* would be normatively distinguishable from cases where the Court holds state taxing schemes to violate the Due Process and Commerce Clauses. This case involves not a question of constitutional wrongdoing by the unsuccessful party, but rather the potential sanctioning of a scheme of state taxation that previously was found to contravene the Constitution.

Unlike *McKesson* and other cases invalidating discriminatory taxing schemes, the adversely affected taxpayers here violated no legal or constitutional duty and impaired the Due Process and Commerce Clause rights of no one. Because there is no conduct that would be proscribed by the Court's decision, prospective-only treatment is justified. Thus, "[a] basic asymmetry exists between decisions contracting and those expanding the domain of individual rights." *See* Richard H. Fallon, Jr. and Daniel J. Meltzer, *New Law, Non-Retroactivity, and Constitutional Remedies*, 104 Harv. L. Rev. 1731, 1745 (1991).[14] *Amicus* TEI believes that where the Court

[14] *Cf. id.* at 1745 n.65 ("The retroactive application of a new decision that effectively criminalized conduct that had been previously held immune from prosecution would presumably deny due

moves to contract the protections afforded by the Due Process and Commerce Clauses, it should do so only on a non-retroactive basis.

Whereas retroactive application of decisions holding particular taxes unconstitutional—such as in *McKesson*—provides a clear incentive for States to avoid unconstitutional taxes, Fallon & Meltzer, *supra*, at 1829, the opposite incentive would be provided by the retroactive overruling of *ASARCO* and *Woolworth*: the States would be encouraged to disregard this Court's clear holdings and to construct taxing schemes that run contrary to long-established principles (such as the unitary business principle). Such an occurrence would be tremendously disruptive. Nothing would be settled and the States would be continually emboldened to impose unconstitutional taxes on the chance that, one day, this Court might relent in its reasoned interpretation of the Constitution's Due Process and Commerce Clause protections.[15]

Amicus TEI believes the States should be placed on notice that they cannot disregard this Court's decisions with impunity and that they will not be permited to reap the benefits of their defiance. At a minimum, therefore, any decision restricting the protections afforded by the Commerce and Due Process Clauses should be applied on a wholly prospective basis.

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process."). Among the cases cited by Fallon and Meltzer is *James v. United States*, 366 U.S. 213, 221-22 (1961) (plurality opinion), in which the Court overruled *Commissioner v. Wilcox*, 327 U.S. 404, 408-09 (1946) (which had held that embezzled funds do not constitute taxable income), but reversed the tax evasion conviction of the defendant-embezzler on due process grounds.

[15] The retroactive overruling of this Court's precedents could be interpreted as an invitation to "state actors to renew the very policies deemed unconstitutional in the hope that this Court may now reverse course, even if it has only recently reaffirmed the constitutional liberty in question." *Payne v. Tennessee*, 111 S. Ct. 2597, 2624 (1991) (Marshall, J., with Blackmun, J., dissenting).

III. TOWARD THE DEVELOPMENT OF NEW CONSTITUTIONAL STANDARDS: SAFEGUARDING DUE PROCESS IN THE ABSENCE OF THE UNITARY BUSINESS PRINCIPLE

In *Container*, the Court discussed the standards against which the legitimacy of a State's apportionment formula is to be measured. Observing that "an apportionment formula must, under both the Due Process and Commerce Clauses, be fair," 463 U.S. at 169, the Court explained:

> The first, and again obvious, component of fairness of an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed. The second and more difficult requirement is what might be called external consistency—the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated.

Id. Even if *ASARCO* and *Woolworth* were overruled and the unitary business principle jettisoned from constitutional decision-making, this test should continue to govern the propriety of state allocation and apportionment schemes.

As demonstrated in Part I, the unitary business principle operates as a constitutional brake on the States' exercise of raw power by proscribing the States' taxation of value earned outside its borders. If that principle is cast aside, new standards must be developed to ensure that the Due Process and Commerce Clause rights of multijurisdictional businesses are not infringed.

Obviously, a balance must be struck between the States' legitimate need for revenues from activities to which the States accord some benefit and taxpayers' legitimate needs for, and right to, protection from taxing authorities that seek to throw a net over income with which the States have no substantial connection. It is for this Court to

ensure that the balance is a reasonable one. As Justice White observed in *Boston Stock Exch. v. State Tax Comm'n*, the Court has a duty "to make the delicate adjustment between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers." 429 U.S. at 329.

The Court has historically accorded a large degree of deference to the States in designing their taxing schemes. *See Moorman Mfg. Co.*, 437 U.S. at 272-73. If the Court should overrule *ASARCO* and *Woolworth*, however, that deference should be clearly circumscribed. In the absence of the unitary business principle, the Court should clarify the principles necessary to minimize duplicative state taxation of intangible income and impose constitutionally based restrictions on the structure of state apportionment formulae. Otherwise, the Due Process and Commerce Clause rights of multijurisdictional taxpayers will suffer.

A. The Need for Uniform Definitions and Apportionment Rules

As explained in Part I.D., *supra*, the evisceration of the unitary business principle would greatly enlarge the potential for duplicative taxation. First, overruling *ASARCO* and *Woolworth* would empower the States to impose tax on intangible income unfettered by the due process considerations that gave rise to the unitary business principle. Although the decision would free the States to apportion such income, it would not necessarily *require* them to do so. Consequently, the same income could be taxable not only by nondomiciliary States (which would be permitted to include it in their apportionable tax base), but also by the State of commercial domicile (which would remain free to allocate the same income in accordance with longstanding principles governing the taxation of business and non-business income). Indeed, several nondomiciliary States might choose to *apportion* the income, whereas one or more other nondomiciliary

States might assert the power to *allocate* the income as attributable to a separate business conducted within their respective borders. Indeed, more than one State might claim that it is the State of commercial domicile and, hence, is entitled to allocate all intangible income. Stated simply, the same income could be subject to tax—not simply apportionment—in several States.

Concededly, the Court has generally eschewed interference with the States' ability to structure their allocation and apportionment schemes. *Moorman Mfg. Co.*, 437 U.S. at 278-79. In a post-unitary business principle environment, however, the Court is obliged to ensure against duplicative taxation. Clearly, there is no constitutional or normative basis for sanctioning the allocation and apportionment (or, indeed, the multiple allocation) of the same income. *Mobil*, 445 U.S. at 444-45, *citing Standard Oil Co. v. Peck*, 342 U.S. at 382, 384 (1952).

Thus, if *ASARCO* and *Woolworth* were overruled, the Court should hold that the States must adopt uniform definitions of the types or items of income that are to be allocated and the types or items of income that are to be apportioned—perhaps even prescribing mandatory apportionment of all intangible income. Clearly, this would represent a significant shift in the relative rights and prerogatives of domiciliary and nondomiciliary States. Clearly, too, it would mark a departure from the view that "only Congress has both the ability to canvass the myriad facts and factors relevant to interstate taxation and the power to shape a nationwide system that [will] guarantee the States fair revenues and offer interstate businesses freedom from strangulation by multiple paperwork and tax burdens." *ASARCO*, 458 U.S. at 331 (O'Connor, J., with Blackmun & Rehnquist, JJ., dissenting).[16]

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[16] *See Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 476 (1959) (Frankfurter, J., dissenting) ("this Court . . . cannot . . . devise appropriate standards for dividing up na-

In the absence of the unitary business principle, however, judicially prescribed uniformity would be essential to striking the proper balance between the power of the States and the rights of multijurisdictional businesses. It would also be essential to vindicating the principles underlying the Due Process and Commerce Clauses. In other words, the Court's well-founded reluctance to assume this duty should lead it not to sanction an "anything goes" approach by the States, but rather to reaffirm the necessity and essential vitality of *ASARCO, Woolworth*, and the unitary business principle while inviting Congress to resolve the issue legislatively.

B. The Compelling Case for Factor Representation

Apart from the need for uniformity is the need for the development of fair apportionment formulae. Here, the issue is not whether the same apportionment formula should be imposed on all the States,[17] but whether the formula used by a particular State is properly designed to guard against the taxation of extraterritorial values.

Amicus TEI submits that, if the Court should rule that a nondomiciliary State is not constrained by the Due Process and Commerce Clauses from apportioning intangible income derived from the business of another corporation, then at a minimum the Court should clarify that the Constitution does not permit such apportionment without taking into account the apportionment factors of the business generating that income. Requiring the States to provide "factor representation" is necessary to prevent the apportionment formula from being unreasonably and impermissibly skewed.

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tional revenue on the basis of more or less abstract principles of constitutional law, which cannot be responsive to the subleties of the interrelated economics of Nation and State.").

[17] This question is one, however, that the Court should revisit if the unitary business principle is discarded. *See Moorman Mfg. Co.*, 437 U.S. at 291-97 (Powell, J., with Blackmun, J., dissenting).

In *Mobil*, this Court acknowledged the factor representation issue, but declined to resolve it because the issue had not been raised by the parties. 445 U.S. at 434, 441 n.15, and 449. In his dissenting opinion in that case, however, Justice Stevens addressed the question directly:

> Clearly, it is improper simply to lump huge quantities of investment income that have no special connection with the taxpayer's operations in the taxing State into the tax base and to apportion it on the basis of factors that are used to allocate operating income. . . .
>
> Unless the sales, payroll, and property values connected with the production of income by the payor corporations are added to the denominator of the apportionment formula, the inclusion of earnings attributable to those corporations in the apportionable tax base will inevitably cause Mobil's Vermont income to be overstated.

445 U.S. at 459, 461 (Stevens, J., dissenting.)

In this case, the State of New Jersey included in the apportionable tax base the substantial capital gain the taxpayer had realized upon the sale of stock in an unrelated company, but the State calculated the apportionment ratio solely by reference to the taxpayer's separate payroll, property, and sales. In other words, the payroll, property, and sales factors *that generated the income* were not taken into account in computing the part of the taxpayer's apportionable income that could be taxed by New Jersey. The failure to provide factor representation produced a result that reflected neither "a reasonable sense of how [the] income [was] generated" (as required by *Container*, 463 U.S. at 169), nor "the relative contribution of the activities in the various States [specifically, New Jersey] to the production of total unitary income" (*Butler Bros. v. McColgan*, 315 U.S. 501, 509 (1942)). As the Maine Supreme Court recently held in *Tambrands, Inc. v. State Tax Assessor*, 595 A.2d 1039 (Me. 1991):

> [Without factor representation,] [t]he ineluctable result is that more of the business activity of the unitary business is attributed to [the State] than is the actual case. Thus, the income taxable by [the State] under the Assessor's formula does not truly reflect [the corporation's] connection with [the State] and fails to meet the test of fairness required by the due process clause.

Id. at 1044.[18] Indeed, the Supreme Court of New Jersey has itself recognized that the State has an obligation to adjust the apportionment formula where the taxpayer is unfairly penalized. *F.W. Woolworth Co. v. Director of Division of Taxation*, 213 A.2d 1, 18 (N.J. 1965).

An apportionment formula that fails by design to take into account the out-of-state property, payroll, and sales that generated the apportioned income should be invalidated as "inherently arbitrary," *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920), because there can never be a "rational relationship between the income attributed to the State and the intrastate values of the enterprise." *Mobil*, 445 U.S. at 437. Without factor representation, therefore, the apportionment for-

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[18] In addition to Maine, several other States have concluded that the failure to provide factor representation in applying the apportionment rules to *unitary* businesses contravenes the Due Process and Commerce Clauses. *See, e.g., NCR Corp. v. South Carolina Tax Comm'n*, 402 S.E.2d 666, 674 (S.C. 1991) (involving interest and royalties from unitary subsidiaries); *American Tel. & Tel. Co. v. Wisconsin Dep't of Revenue*, 422 N.W.2d 629, 636 (Wis. App. 1988) (involving dividends from unitary subsidiaries); *NCR Corp. v. Comptroller of the Treasury*, 544 A.2d 764, 781 (Md. 1988) (involving dividends and royalties from unitary subsidiaries); *Homart Dev. Co. v. Norberg*, 529 A.2d 115, 121 (R.I. 1987) (involving distributive share from partnership). *See* E. George Rudolph, *supra*, 25 Tax L. Rev. at 205 ("Obviously, if the foreign source income is included in the base for apportionment, foreign property, payrolls, and sales must be included in the apportionment fractions. This was recognized in *Bass* [, *Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271 (1924] . . .").

mula should be struck down as violating both the internal and the external consistency tests of *Container*. 463 U.S. at 169-70.

In summary, the Court should hold that where a State seeks to apportion intangible income (including capital gains and dividends derived from equity investments), then the State's apportionment formula must be modified to include an appropriate portion of the payor company's payroll, property, and sales. Only by requiring factor representation can the Court vindicate the constitutional requirement of a "fair" apportionment formula. *Container*, 463 U.S. at 169.[19]

IV. SUMMARY

In holding for the State in the proceeding below, the New Jersey Appellate Division stated that "*ASARCO* and *F.W. Woolworth* cast a dark shadow over the Tax Court's decision . . . ." A truer statement is that the decision of the New Jersey Supreme Court, if left to stand, would do more than cast a shadow: it would blot out constitutional protections of more than a century's duration.

Overruling *ASARCO* and *Woolworth* would lead in due course to an unraveling of more than 100 years of consti-

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[19] Moreover, the Court should expressly reaffirm its holding in *Woolworth* that a State's taxation of hypothetical or fictitious income (through its inclusion in the apportionable tax base) contravenes the Due Process Clause. 458 U.S. at 372-73. The term "fictitious income" includes so-called gross-up amounts that a taxpayer never received but that the Federal Government *deems* it to receive from its foreign subsidiaries for purposes of computing the taxpayer's federal foreign tax credit. *See* I.R.C. § 78. In *Woolworth*, the Court dismissed with dispatch the State's argument that *deemed* income was apportionable. That portion of the holding should be reaffirmed even if the unitary business principle is eviscerated by the Court. *Accord George, Inc. v. Norberg*, 444 A.2d 868, 870 (R.I.), *cert. denied*, 459 U.S. 908 (1982); *Commonwealth v. Emhart Corp.*, 278 A.2d 916, 921 (Pa. 1971); *Getty Oil Co. v. Director of Revenue*, CCH Del. State Tax Rptr. ¶ 200-286 (Del. Tax App. Bd. 1975).

tutional jurisprudence. It would rob taxpayers and the States alike of certainty. And it would undermine the principles underlying the Due Process and Commerce Clauses. Consequently, *amicus* TEI urges the Court to reaffirm the vitality of the unitary business principle, refrain from overruling its fact-based decisions in *ASARCO* and *Woolworth*, and send an unmistakable signal to the States that they may not tax extraterritorial income where they have not "given anything for which [they] can ask return."

CONCLUSION

The decision of the Supreme Court of New Jersey should be reversed.

Respectfully submitted,

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